

REVISED AGENDA — April 4, 2000 Business Taxes Committee Meeting
Proposed Revisions to Audit Manual Chapter 5, Penalties
Revised March 30, 2000

Action 1 - Consent Item Proposed revisions to Audit Manual Chapter 5, <i>Penalties</i> .	Adopt proposed revisions as agreed upon by interested parties and staff (illustrated in Exhibit 2). Operative Date: None. Implementation: Upon Board Approval.
Action 2 - Standard of Proof for Supporting an Evasion Penalty (Audit Manual Section 0507.30).	Adopt either: 1) Staff's recommendation to make no revision to Audit Manual Section 0507.30 relating to the standard of proof for evasion penalties being "clear and convincing evidence." (The current language does not specify the exact standard of proof, but does provide that substantial amount of evidence must be presented to support a recommendation for an evasion penalty.) OR, 2) Associated Sales Tax Consultants' (ASTC) proposed language to include "clear and convincing evidence" as the standard of proof in Audit Manual Section 0507.30. ASTC requests no operative date. Operative Date: None. Implementation: Upon Board Approval. OR, 3) If the Board adopts ASTC's proposal, use the date of approval as the operative date. Operative Date: Upon Board Approval. Implementation: Upon Board Approval.
Action 3 - Approval to Publish	Approve the publication of the proposed revisions to Audit Manual Chapter 5, <i>Penalties</i> , as adopted in the above actions.

REVISED AGENDA — April 4, 2000 Business Taxes Committee Meeting
Proposed Revisions to Audit Manual Chapter 5, Penalties
Revised March 30, 2000

Action Item	Staff and Industry's Proposed Regulatory Language
Action 1 — Consent Item Revisions to Audit Manual Chapter 5, except for language in section 0507.30, Burden of Proof, relating to the standard of proof required to support a recommendation of an evasion penalty.	Adopt proposed revisions as agreed upon by interested parties and staff (Exhibit 2).

REVISED AGENDA — April 4, 2000 Business Taxes Committee Meeting
Proposed Revisions to Audit Manual Chapter 5, Penalties
Revised March 30, 2000

Action Items	Staff's Proposed Revised Language	Interested Party's Proposed Revised Language	Comments
Action 2 - Standard of Proof for Supporting an Evasion Penalty (Audit Manual Section 0507.30).	<p>BURDEN OF PROOF 0507.30</p> <p>As a matter of law, fraud is never presumed but must be proven <u>and the burden of proof is on the Board. However, the burden of proof is not beyond a reasonable doubt as in a criminal prosecution. (See Helvering v. Mitchell (303 U.S. 391 406)). As noted in Sections 0507.20 and 0507.25, a taxpayer's intent to evade the tax is the key element to proving fraud. The mere fact that a taxpayer has a substantial tax liability does not in and of itself prove intent. Rather the evidence must support intent. For example, a consistent pattern of underreporting may indicate evasion, particularly if there is no other explanation for the understatement. However, additional evidence such as falsified records must be provided to support fraud when the underreporting is random. In all cases where a fraud penalty is recommended, the district administrator must be prepared to submit evidence of a substantial nature that the taxpayer knowingly committed specific acts with the intention of defrauding the State of tax, which was legally due. (See Section 0507.75 0508.20.)</u></p>	<p>BURDEN OF PROOF 0507.30</p> <p>As a matter of law, fraud is never presumed but must be proven <u>and the burden of proof is on the Board. The standard of proof that the staff has to meet to support a recommendation of an evasion penalty is clear and convincing evidence. However, the burden of proof is not beyond a reasonable doubt as in a criminal prosecution. (See Helvering v. Mitchell (303 U.S. 391 406)). As noted in Sections 0507.20 and 0507.25, a taxpayer's intent to evade the tax is the key element to proving fraud. The mere fact that a taxpayer has a substantial tax liability does not in and of itself prove intent. Rather the evidence must support intent. For example, a consistent pattern of underreporting may indicate evasion, particularly if there is no other explanation for the understatement. However, additional evidence such as falsified records must be provided to support fraud when the underreporting is random. In all cases where a fraud penalty is recommended, the district administrator must be prepared to submit evidence of a substantial nature that the taxpayer knowingly committed specific acts with the intention of defrauding the State of tax, which was legally due. (See Section 0507.75 0508.20.)</u></p>	<p>Staff is of the opinion that establishing the standard of proof through the revision of an Audit Manual chapter is not appropriate. The staff currently uses "preponderance of the evidence," the standard for civil fraud. The Board may set a higher standard for staff recommendations to the Board for evasion penalties. However, staff believes that regulatory action would be preferable to establishing a higher standard through language in the audit manual.</p>

Issue Paper Number 00 - 009 Revised



- ☐ Board Meeting
- ☒ Business Taxes Committee
- ☐ Customer Services and Administrative Efficiency Committee
- ☐ Legislative Committee
- ☐ Property Tax Committee
- ☐ Other

Proposed Revisions to Audit Manual Chapter 5, Penalties

I. Issue

Should staff's proposed revisions to Chapter 5, *Penalties*, be incorporated into the Sales and Use Tax Department's Audit Manual?

II. Staff Recommendation

Staff recommends that the proposed revisions as illustrated in the attached draft of Chapter 5 (Exhibit 2) be incorporated into Chapter 5 of the Audit Manual. No operative date is proposed since the revisions simply clarify existing policy.

III. Other Alternative(s) Considered

Alternative 1

Associated Sales Tax Consultants (ASTC) accepts revisions recommended by staff, but proposes the addition of language to section 0507.30 that states that the standard of proof to support recommendation of an evasion penalty is "clear and convincing evidence." ASTC proposes that this revision have no operative date.

Alternative 2

Make no changes to Chapter 5.

Alternative 3

If the Board adopts ASTC's proposal to add language making the standard of proof "clear and convincing evidence," staff recommends that the change become operative upon that approval.

IV. Background

The Audit Manual (AM) is the Board of Equalization's (Board) guide for conducting sales and use tax audits. The thirteen chapters contained within the AM incorporate procedures and techniques that have evolved over the years and have been proven to be sound and practical. Field auditors are required to carefully study these procedures and techniques to ensure that audits are conducted and reports prepared in a clear and uniform manner consistent with approved audit policies and procedures.

Chapter 5, *Penalties*, states the Board's policy regarding the imposition of penalties. The chapter lists the penalties, both mandatory and discretionary, provided for under the Sales and Use Tax Law. It discusses the responsibilities of field auditors and supervisors when imposing discretionary negligence and fraud penalties and explains when mandatory delinquency and failure to file penalties apply. The chapter also defines negligence and fraud and provides guidelines for the imposition of these penalties. The last revisions to Chapter 5 were published in March 1983.

In section 0501.05, Chapter 5 states the Board's policy on penalties:

It is the policy of the Board to encourage and assist all taxpayers to make an accurate and timely self-declaration of their tax liability. When that (accurate and timely self-declaration) is done, there should be no occasion for imposition of penalties for negligence or fraud. The Board recognizes the many difficulties that taxpayers may be confronted with in attempting to comply with all requirements of the law. While unduly rigid or exacting requirements are not in the best interest of good tax administration, the Board does not condone carelessness or deliberate disregard by taxpayers of their obligations to keep accurate records and prepare proper returns. *Whenever there is any doubt as to whether factual conditions warrant a penalty for negligence or fraud, that doubt should be resolved in favor of the taxpayer.* However, where penalties are justified by the acts or omissions of the taxpayer, they should be applied properly and impartially.

Staff received comments from four interested parties relating to the revision of Chapter 5. Two of the interested parties, Mr. Norman Jung, Manager of Sales and Property Tax Audits for Sun Microsystems, Inc. and Ms. Angela Hoyt, Director of Domestic Tax for the Motion Picture Association of America, Inc., were concerned that current language in various sections of the AM implied a bias toward the imposition of penalties. They felt this was contrary to the stated policy. There were also concerns about the clarity of certain guidelines used to determine if a negligence penalty is warranted. Both interested parties suggested revisions to the current language that they felt would address their concerns. These suggestions were adopted.

One interested party, Mr. Abe Golomb of Associated Sales Tax Consultants, expressed concern about the clarity of the AM's current guidelines on imposition of evasion penalties. In particular, Mr. Golomb felt that there should be more emphasis on the Board's responsibility to prove evasion and on the responsibility of auditors to provide evidence of evasion. Mr. Golomb made several suggestions that were incorporated into the revised chapter.

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Two interested parties, Mr. Golomb and Mr. Joseph Micallef of Associated Sales Tax Consultants, expressed concern about the standard of proof used by the Board to impose evasion penalties. Currently, the Board uses the standard of “preponderance of the evidence.” Mr. Micallef and Mr. Golomb suggested that all taxing agencies should be held to the standard of “clear and convincing evidence.” Staff reviewed Mr. Micallef’s and Mr. Golomb’s suggestion and determined that a change in the standard of proof to “clear and convincing evidence” was beyond the scope of the proposed revision to Chapter 5. The Board’s current standard of “preponderance of the evidence,” is supported by two court cases: *Marchica v. State Board of Equalization*, 107 Cal.App.2d 501, 237 P.2d 725 (1951), and *Liodas v. Sahadi*, 19 Cal.3d 278, 137 Cal.Rptr. 635, 562 P.2d 316 (1977). Both of these cases state that preponderance of the evidence is the proper standard of proof. Staff believes that a change of the standard of proof requires legislative action.

Even though other Board departments already follow guidelines specific to their tax or fee program, it should be noted that the proposed revisions to AM Chapter 5, *Penalties*, reflect Board-wide policy on the level of care required when recommending penalties and on the resolution of a penalty recommendation when facts are in doubt. Therefore, other departments will implement the proposed revisions adopted by the Board unless program-specific statutes, regulations, or Board decisions take precedence.

Discussion – Proposed Revisions to Chapter 5

The substantive proposed revisions to Chapter 5 incorporate information about penalties enacted since the last revision, incorporate Sales and Use Tax Department (Department) guidelines developed subsequent to the last revision, and clarify guidelines for recommending negligence and evasion penalties. There are also less substantive, but important proposed revisions that are detailed starting on page 6.

Penalties Enacted Since the Last Revision

The penalties enacted since the last revision are added to the summary of penalties that may be assessed by auditors in section 0501.10. In addition, new sections are incorporated into the chapter that discuss the penalty provisions in detail. The penalties, their Revenue and Tax Code (RTC) section, and the AM chapter sections are:

- Knowingly operating without a valid permit. Enacted by RTC 7155, effective September 27, 1984; incorporated by AM section 0507.50.
- Improper use of a resale certificate. Enacted by RTC sections 6072, operative January 1, 1981, and 6094.5, effective July 17, 1984; incorporated by AM section 0507.55.
- Registration of a vehicle, vessel or aircraft outside the state to evade tax. Enacted by RTC sections 6485.1 and 6514.1, effective September 27, 1984; incorporated by AM section 0507.60.
- Failure to ascertain whether the operator of a catering truck holds a valid seller’s permit. Enacted by RTC section 6074, effective January 1, 1986; incorporated by AM section 0508.05.
- Failure of a retail florist to obtain a permit. Enacted by RTC section 6077, effective January 1, 1997; incorporated by AM section 0508.10.

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It has been the policy of the Department that all penalty recommendations must be supported by adequate comments, and that the recommendations for evasion penalties must be adequately documented. Since the last revision of Chapter 5, the Department has developed additional guidelines for penalty comments, documentation of evasion penalties, and the extension of an audit beyond the statute of limitations due to evasion. The guidelines on audit comments are incorporated in AM section 0504.35, *Penalty Comments on Audit Reports and FBOs*. These guidelines emphasize the need for a clear and complete statement that explains why a penalty was imposed and if not, why not. In particular, these guidelines caution auditors against the use of canned comments to support a recommendation, the importance of being factual, and the need to avoid derogatory comments about taxpayers or their employees. To promote consistency in the application of penalties and the writing of comments, the guidelines also require additional review and written approval of the recommendation and comments by district management when the audit deficiency is in excess of \$25,000.

The guidelines on documentation of evasion penalty recommendations are incorporated into AM section 0507.75, *Approval of Evasion Penalties*. These guidelines require that all recommendations for evasion penalties be accompanied by a memorandum to the Program Planning Manager from the District Administrator. The memorandum must be approved by the District Administrator and it must detail all the facts and circumstances which are the basis for the evasion penalty recommendation. Based on the information provided in the memorandum, the Program Planning Manager will determine if the evasion penalty should be imposed.

The guidelines on extension of an audit beyond the statute of limitations due to evasion are incorporated into AM section 0507.70, *Statute of Limitations for Evasion Penalties*. These guidelines require that substantive evidence of underreporting in periods outside the statute of limitations exists before the audit period can be extended. In particular, records must be available for review, they must establish an actual tax liability, and the evidence available must support the assertion of fraud. In addition, if the prior periods have already been audited, they cannot be included in a subsequent audit unless evasion was present and was not discovered because information was concealed from the auditors.

Clarification of Guidelines on Penalty Recommendations

Comments from interested parties indicate that there is agreement on the Board's general policy on imposition of penalties. This policy is stated in AM section 0501.05 and is stated in its entirety in the Background section on page two of this issue paper. The policy recognizes that compliance with the Sales and Use Tax Law is not easy and that rigid and exacting requirements are not in the best interests of good tax administration. At the same time, the Board also notes that a taxpayer has the obligation to report accurately, to obey the law, to keep accurate records, and to file proper returns. If a taxpayer does not fulfill his or her obligation, penalties are justified. However, in any instance where there is doubt about whether a penalty should apply, the doubt is to be resolved in favor of the taxpayer.

Although interested parties agree with this policy, they felt Chapter 5 did not accurately reflect the policy. Specifically, interested parties felt that some subsections of the chapter implied that certain conditions should automatically result in a penalty recommendation; that comment guidelines required more support when a penalty was not recommended; and that AM Section 0507.00, *Evasion Penalties*, was insufficiently clear as to the Board's responsibility for proving fraud.

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The guidelines that appeared to mandate a penalty appear in AM sections 0506.05, *Deficiency Due to Misunderstanding*, and 0505.45, *Considerations in Classifying Errors*. The pertinent language in AM section 0506.05 states, “where the taxpayer has been advised as a result of a prior audit or by other means, that the unreported items were subject to tax, the 10 percent penalty normally shall apply.” Interested parties feel that this language is interpreted by auditors as a firm rule and no attempt is being made to consider mitigating circumstances. The proposed revision clarifies this section by stating that this circumstance is “indicative of intentional disregard” and advising the auditors to consider mitigating circumstances.

Interested parties’ concerns with AM section 0505.45 center on how errors are considered when deciding whether a negligence penalty applies. The current language of the subsection states:

To determine whether errors constitute negligence, the following should be considered:

- a) The frequency of errors,
- b) The size of the ratio of understatement resulting therefrom, and
- c) The probable cause.

Interested parties feel that auditors are assuming that a significant frequency of error or large ratio of understatement should automatically result in a negligence penalty recommendation. In particular, they feel that auditors do not consider whether the frequency of errors is reasonable based on the size or type of business, nor do auditors always correctly calculate the ratio of understatement. The proposed revision advises auditors to research the cause of the frequency and of the errors and to consider whether it is unreasonable in relation to the type or size of business. The revision also provides examples of accurate ratio analysis.

Guidelines for penalty comments are provided in AM section 0504.35, *Penalty Comments on Audit Reports or FBOs*. As noted in the previous section on page 4, the Department has incorporated expanded guidelines for penalty comments. Interested parties feel that the expanded guidelines are an improvement over the current language. However, they feel that the Department guidelines require greater support when a penalty is not recommended. In response to these concerns, the revised AM section 0504.35 has the same requirements for comments whether or not a penalty is recommended.

Guidelines for asserting an evasion penalty are provided by AM Section 0507.00. This section lists the evasion penalties authorized by the law and details the responsibilities of the Board for determining and supporting an evasion penalty. Interested parties feel that the information in the current section is accurate, but does not sufficiently emphasize that the Board has the burden of proof when asserting evasion, or that the evidence presented must establish an intent to evade. To emphasize the Board’s burden of proof, the revision places an italicized statement in the first paragraph of the section and the information is reiterated in later sections. Under audit manual usage guidelines, auditors are required to comply with an italicized statement. The revision also emphasizes in AM section 0507.25, *Evidence of Evasion*, that auditors have the responsibility to gather sufficient evidence that supports the finding of intent to evade the tax on the part of the taxpayer and that this evidence must be summarized and referenced in the audit working papers. The revision provides brief guidelines on evidence of intent in AM section 0507.30, *Burden of Proof*.

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In addition to specific changes suggested by interested parties, the revisions provide other needed changes. The revisions provide additional context for the guidelines by referring to applicable law sections. The revisions also emphasize that the level of analysis, when considering a penalty, is the same as when auditing. That is, an auditor must use his or her highest skill and best judgement when considering the evidence at hand. Finally, the revisions provide guidelines for determining whether a penalty should be recommended on a first audit.

Other Significant Changes

In addition to the incorporation of the new penalties and Department policies and guidelines, the following information has been added to Chapter 5.

- AM section 0501.20, *Delinquency Penalties*, has been updated to include information about delinquency penalties on EFT payments and on prepayments. These revisions are based on the enactment of RTC section 6479.3 on EFT payments and the amendment of RTC section 6477 concerning delinquent prepayments.
- AM section 0503.15, *What Constitutes Filing a Return or Report*, has been updated to reflect expanded Board administrative policy on the elements of a valid sales and use tax return.
- AM section 0503.30, *Closeouts with Securities*, clarifies the Board policy of not asserting a penalty when a deficiency is paid by security provided by the taxpayer.
- AM section 0507.65, *Multiple Penalties*, has been added to explain when more than one penalty may apply to a single liability.

Summary

Issuance of appropriate guidelines and auditing procedures is an essential part of the effective administration of California's self-assessed sales and use tax program. Maintaining an accurate, complete, and up-to-date Audit Manual is necessary to accomplish this goal. The proposed changes to Chapter 5 formalize administrative policies and recommend appropriate auditing procedures that conform to standard practices. Incorporation of these proposed revisions into the Audit Manual will further the Board's commitment to maintain an efficient and effective tax program implemented by knowledgeable and qualified staff, as well as providing guidance and information to the public.

V. Staff Recommendation**A. Description of the Staff Recommendation**

Staff recommends that the proposed revisions as illustrated in the attached draft of Chapter 5 (Exhibit 2) be incorporated into Chapter 5 of the Audit Manual. No operative date is proposed since the revisions simply clarify existing policy.

B. Pros of the Staff Recommendation

- Updates the Audit Manual for penalties enacted since the last revision

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- Incorporates policy changes already in effect
- Provides a more comprehensive context for recommending penalties
- Clarifies current guidelines

C. Cons of the Staff Recommendation

None.

D. Statutory or Regulatory Change

None required.

E. Administrative Impact

None. Policies are already in effect.

F. Fiscal Impact

1. Cost Impact

None.

2. Revenue Impact

None.

G. Taxpayer/Customer Impact

A better understanding of the guidelines and basis for asserting penalties is expected to improve customer relations.

H. Critical Time Frames

No operative date is proposed. Revised AM Chapter 5 will be posted on the Board's Website and distributed to staff.

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VI. Alternative 1

A. Description of the Alternative

Accept revisions recommended by staff, but add language to section 0507.30 that states that the standard of proof to support recommendation of an evasion penalty is “clear and convincing evidence.”

B. Pros of the Alternative

Clarifies standard of proof required when recommending an evasion penalty.

The Franchise Tax Board uses the “clear and convincing evidence” standard of proof to support recommendations for evasion penalties.

C. Cons of the Alternative

Using the standard of proof of “clear and convincing evidence” for evasion penalties is inconsistent with the legal standard of proof for civil fraud, which is “preponderance of the evidence.”

D. Statutory or Regulatory Change

May require regulatory change.

E. Administrative Impact

None.

F. Fiscal Impact

1. Cost Impact

None.

2. Revenue Impact

Minimal revenue loss. See revised Revenue Estimate (Exhibit 1).

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G. Taxpayer/Customer Impact

None.

H. Critical Time Frames

No operative date.

VII. Alternative 2

A. Description of the Alternative

Make no changes to Chapter 5.

B. Pros of the Alternative

None.

C. Cons of the Alternative

Audit Manual Chapter 5 would not be consistent with current policies and procedures.

D. Statutory or Regulatory Change

None.

E. Administrative Impact

None.

F. Fiscal Impact

1. Cost Impact

None.

2. Revenue Impact

None.

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G. Taxpayer/Customer Impact

None.

H. Critical Time Frames

None.

VIII. Alternative 3

A. Description of the Alternative

If the Board adopts ASTC's proposal to add language making the standard of proof "clear and convincing evidence," staff recommends that the change become operative upon that approval.

B. Pros of the Alternative

Avoids the confusion that would occur in determining the standard of proof used in prior evasion penalty assessments, if taxpayers file claims for refund on the basis that the incorrect standard of proof was used to assess the evasion penalties.

C. Cons of the Alternative

Inconsistent with the proposal submitted by the interested party.

D. Statutory or Regulatory Change

None.

E. Administrative Impact

None.

F. Fiscal Impact

1. Cost Impact

None.

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2. Revenue Impact

None.

G. Taxpayer/Customer Impact

None.

H. Critical Time Frames

Operative date to start upon approval by Board.

Prepared by: Program Planning Division, Sales and Use Tax Department

Current as of: March 30, 2000



PROPOSED REVISIONS TO AUDIT MANUAL CHAPTER 5, *PENALTIES*

Staff Recommendation

Staff recommends that the proposed revisions be incorporated into Chapter 5 of the Audit Manual, as illustrated Exhibit 2 of the issue paper.

Alternative 1

This proposal would change the standard of proof for supporting an evasion penalty from the standard for civil fraud of “preponderance of the evidence” to a higher standard of “clear and convincing evidence”.

Alternative 2

Make no revisions to Chapter 5 of the Audit Manual.

Background, Methodology, and Assumptions

Staff Recommendation:

There is nothing in the proposed revisions to Chapter 5 of the Audit Manual that would impact revenues.

Alternative 1:

Alternative 1 would set a higher standard to support evasion penalties. During 1998-99, the Board assessed \$2.6 million in evasion penalties. A portion of this amount could be lost, if it was determined that the higher standard of proof was not met. Any decrease in the amount of evasion penalties levied will depend on staff determination of whether or not they can support the higher standard of proof and ultimately, on a determination by the courts as to what constitutes “clear and convincing evidence”.

Alternative 2:

Alternative 2 would not impact revenues.

Revenue Summary

Staff Recommendation:

The staff recommendation has no revenue effect.

Alternative 1:

Alternative 1 could have an effect on the amount of evasion penalties levied, due to the adoption of a higher standard of proof. The effect is estimated to be minor.

Alternative 2:

Alternative 2 has no revenue effect.

Preparation

This revenue estimate was prepared by David E. Hayes, Statistics Section, Agency Planning and Research Division. This revenue estimate was reviewed by Ms. Laurie Frost, Chief, Agency Planning and Research Division and Ms. Freda Orendt-Evans, Program Planning Manager, Sales and Use Tax Department. For additional information, please contact Mr. Hayes at (916) 445-0840.

Revised as of March 30, 2000

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CHAPTER 5

PENALTIES

0500.00

INTRODUCTION

0501.00

BOARD POLICY ON PENALTIES

0501.05

It is ~~a~~ the policy of the Board to encourage and assist all taxpayers ~~to in~~ making an accurate and timely self-declaration of their tax liability. When that is done, there should be no occasion for imposition of penalties for negligence or fraud. ~~The Board recognizes the many difficulties that with which taxpayers may be confronted~~ with in attempting to comply with all requirements of the law. ~~While it does not believe that~~ unduly rigid or exacting requirements are not in the best interests of good tax administration, ~~the Board~~ it ~~also~~ does not condone carelessness or deliberate disregard by taxpayers of their obligations to keep accurate records and ~~prepare~~ make proper returns. *Whenever there is any doubt as to whether factual conditions warrant a penalty for negligence or fraud, that doubt should be resolved in favor of the taxpayer.* However, where penalties are justified by the acts or omissions of the taxpayer, they should be applied properly and impartially.

SUMMARIZATION OF TYPES OF PENALTIES - OVERVIEW

0501.10

~~The various business tax laws covered by this audit manual provide for five different types of penalties. The nature and rate for each type may be summarized as follows: The sSales and uUse tTax lLaws sections covered by this audit manual provide for several penalties. There are penalties that are mandatory and imposed automatically, such as those imposed because payments are late, without regard to whether an audit is performed. There are others that are discretionary and are may be assessed by auditors in the conduct of their audits. The main penalties that auditors will be concerned with may assess are summarized as follows:~~

<i>Nature</i>	<i>Rate</i>
(a) Failure to file a timely return.....	10%
(b) Failure to pay tax within the time required by law (delinquencies, Section 0501.20)	10%
(c) Negligence or intent to disregard the law or regulations.....	10%
(d) Fraud or intent to evade the law or regulations.....	25%
(e) Failure to make required prepayments	6%

<u><i>Nature of Penalty</i></u>	<u><i>Rate</i></u>	<u><i>Law Section</i></u>
a) <u>Failure to file a return</u>	<u>10%</u>	<u>6511</u>
b) <u>Negligence or intentional disregard of the laws or regulations</u>	<u>10%</u>	<u>6484</u>
c) <u>Fraud or intent to evade the law or regulations</u>	<u>25%</u>	<u>6485</u>
d) <u>Knowingly not obtaining failure to obtain a valid permit in order to avoid the tax</u>	<u>50%</u>	<u>7155</u>
e) <u>Improper use of a resale certificate for personal gain or to evade the tax</u>	<u>*</u>	<u>6072; 6094.45</u>

<u>Nature of Penalty</u>	<u>Rate</u>	<u>Law Section</u>
f) <u>Registration of vehicle, vessel, or aircraft out of state to evade the tax</u>	<u>50%</u>	<u>6485.1; 6514.1</u>
g) <u>Failure to obtain evidence that operator of catering truck holds valid seller's permit</u>	<u>\$500</u>	<u>6074</u>
h) <u>Failure of retail florist to obtain permit</u>	<u>\$500**</u>	<u>6077</u>

*10% of the tax due or \$500 whichever is greater

**Plus any other applicable penalty

RESPONSIBILITY OF FIELD AUDITORS FOR PENALTY RECOMMENDATIONS

0501.15

Most negligence and fraud penalties are imposed as a part of the determinations based upon field audit recommendations. ~~It is a prime responsibility of the field auditors and their supervisors are responsible for making to make sound penalty recommendations based upon factual findings. This requires auditing competency, a thorough understanding of the penalty provisions of the law, good judgment, and common sense and a thorough understanding of the penalty provisions of the law.~~

A negligence penalty and a fraud penalty can never apply ~~concurrently to the same amount of tax.~~ The two penalties are mutually exclusive. The same is true of the penalty for negligence and the penalty for failure to ~~make file~~ a return. However, a ~~25% penalty for fraud~~ fraud penalty and a 10% penalty for failure to file may be added to the same tax.

Whenever circumstances warrant the imposition of either a mandatory ~~penalty~~ or a discretionary penalty, ~~but not both, the mandatory penalty will apply. i.e. For example, the penalty for failure to file a return rather than the negligence penalty will~~ should apply in those cases where either penalty could be applied.

DELINQUENCY PENALTIES

0501.20

For taxpayers not paying their taxes by EFT when they are required to do so, Section 6591 of the Sales and Use Tax Law imposes a 10% penalty for failure to pay tax timely. On and after January 1, 1997, this section also imposes a 10% penalty for failure to file a timely return. For taxpayers paying their taxes by EFT, as of January 1, 1999, Section 6479.3 includes all EFT related penalties. The penalties imposed under either of these sections are limited to a maximum of 10% of the amount of taxes, exclusive of prepayments, for the reporting period. If a taxpayer fails to file a timely return, a penalty of 10% of the amount of taxes, exclusive of prepayments, is incurred under mandatory provisions of the laws. Failure to make a timely payment when filing a return or paying a determination also results in a mandatory 10% penalty. However, this penalty should not be included in audit reports.

~~These penalties are not accumulative; only one penalty will apply.~~

(Cont.) 0501.20

Returns are considered to cover the period which is indicated on them~~thereon~~. For example, ~~a return covering the period 5/15/XX to 6/30/XX would not preclude the application of a failure to file penalty to the period 5/1/XX to 5/14/XX if no return was made for this period~~ a taxpayer on a monthly basis does not report sales for May, but instead includes these sales on his or her June return. The failure to file penalty would apply to May even though sales were subsequently reported in June.

Section 6476 imposes a 6 percent penalty on the amount of a prepayment that is paid late but which is paid before the last day of the monthly period following the quarterly period in which the prepayment was due.

Section 6477 imposes a penalty when a taxpayer fails to make the a prepayment noted in the above paragraph but files before the last day of the monthly period following the quarterly period in which the prepayment became due, provided the taxpayer files a timely return and payment for the quarterly period in which the prepayment became due. The penalty is shall pay a penalty of 6% of the amount equal to 90% of the tax liability for each of the monthly periods during that quarterly period for which a required prepayment was not made.

The penalty imposed under section 6477 is increased by Ssection 6478 to 10 percent if the failure to make the prepayment was due to negligence or intentional disregard of the Sales and Use Tax Law or authorized rules and regulations. Section 6478 also imposes a 10 percent penalty on the amount of any deficiency in the required prepayment if any part of that deficiency is the result of negligence or intentional disregard of the Sales and Use Tax Law or authorized rules and regulations. The penalties discussed in this paragraph are not applicable to amounts subject to a penalty under Ssections 6484, 6485, 6511, 6514, or 6591.

~~Failure to make a prepayment because of negligence or intentional disregard requires a 10% rather than a 6% penalty.~~

~~Deficiency in a prepayment resulting from negligence or intentional disregard requires a 10% penalty.~~

~~The prepayment penalties noted above do not apply to any amounts on which penalties have been asserted under other sections of the law.~~

WAIVER OF MANDATORY PENALTIES**0501.25**

The Board is empowered to relieve taxpayers of mandatory penalties for failure to file a timely return, payment, or prepayment when ~~it is~~ the Board determines that the failure was due to a reasonable cause and circumstances beyond the person's control and occurred notwithstanding the exercise of ordinary care.

Relief from penalties will be considered by the Board Members at ~~its~~ their regular meetings. Taxpayers wishing to request relief should do so after issuance of a determination. ~~A Request for relief should must~~ be presented in a written statement, under penalty of perjury, setting forth the facts upon which the request ~~is~~ claims are based.

PENALTIES FOR NEGLIGENCE AND FRAUD**0501.30**

These penalties are imposed when there is "negligence or intentional disregard" or "fraud or intent to evade" the law or rules and regulations, and may be asserted only as a part of determinations made by the Board under the laws. Such penalties may be protested and are subject to cancellation if they subsequently are found to have been asserted in error.

On July 19, 1944, the Board ~~on July 19, 1944,~~ ordered that when a "fraud" or "intent to evade" penalty has been imposed (i.e., billed on a Notice of Determination), any change in such penalty ~~will~~ shall be made only by ~~them~~ the elected Board itself as opposed to being made and not by Board staff.

PENALTIES IN BANKRUPTCY CASES**0501.35**

In bankruptcy cases, penalties are chargeable to the various parties involved, as indicated below. It will be noted that these instructions also ~~include~~ apply to debtors in possession under Chapters X and XI of the Bankruptcy Act.

Section ~~57~~ 507(a)(8) of the Bankruptcy Act ~~Code~~ does not permit a tax penalty to be filed as a priority claim ~~prohibits allowance of tax penalties in claims~~ against the bankrupt estate in regular bankruptcy proceedings. Accordingly, no penalties attaching under any of the provisions of the business tax laws can be included in the priority claim against the bankrupt estate in such proceedings. However, the penalties become the personal liability of the ~~bankrupt debtor~~, whether attaching before or after the date of the petition in bankruptcy, unless chargeable against a trustee, receiver or "debtor in possession" or unless corporate reorganization or arrangement proceedings are involved. Any appropriate penalties should be included when submitting Form ~~BTOE~~ 414-A so that steps may be taken to collect such penalties under personal liability of the ~~bankrupt debtor~~ after discharge.

RECEIVERS, TRUSTEES AND DEBTORS IN POSSESSION**0501.40**

Receivers or trustees of bankrupt estates and debtor in possession under Chapter X or XI are liable for penalties incurred while operating the bankrupt business. Accordingly, penalties which attach by reason of the delinquency or misfeasance of a receiver, trustee, or debtor while operating the bankrupt business will be billed against such receiver, trustee, or debtor.

NEGLIGENCE AND EVASION PENALTIES—DECEASED TAXPAYERS**0501.45**

Negligence and evasion penalties will not be included in determinations made after the death of an individual taxpayer. It is obvious that the malfeasant in such cases would not suffer the penalty, but the effect would be to reduce the assets for distribution to the estate of the deceased. However, such penalties are applicable ~~may apply~~ to the operations ~~negligence or evasion of the administrator(s) or executor(s)~~ of the decedent's estate ~~by administrators or executors~~.

NEGLIGENCE AND EVASION PENALTIES—DEATH OF PARTNER**0501.50**

If a partnership is properly subject to a negligence or evasion penalty, that penalty will still be imposed even if the partnership is thereafter dissolved due to death of one of the partners.

ASSIGNMENT FOR THE BENEFIT OF CREDITORS**0501.55**

Any person who makes an assignment for the benefit of creditors and who owes an amount which became delinquent either before or after the assignment was made is charged with penalty and interest, when applicable, the same as other taxpayers.

PENALTY APPLICABLE WHEN PARTNER DIES**0501.55**

~~When a partnership is dissolved due to death of one of the partners, penalties for negligence or evasion may be imposed.~~

LOCAL AND TRANSACTIONS TAXES**0501.60**

The penalty provisions of this chapter also apply to Uniform Local Sales and Use Taxes and Transactions (Sales) and Use Taxes. The penalties for negligence and evasion normally will apply to state, local, and transactions taxes. However, a recommendation for penalty may be restricted to state tax and not local tax, and not transactions tax, or any combination, as appropriate ~~vice versa~~.

DELINQUENCY PENALTIES**0502.00****WHEN PENALTY ATTACHES****0502.05**

Delinquency penalty attaches if tax is not paid, as follows:

- a) To self-declared tax, on or before the due date of the return; or ~~on or before the expiration date of any extension, if an extension that~~ has been granted.
- b) To determinations made by the Board, on or before the penalty date shown on the Notice of Determination unless a timely petition has been filed;
- c) To redeterminations, on or before the penalty date shown on the Notice of Redetermination.

DUE DATES ON RETURNS REPORTING BASIS**0502.10**

Sales tax returns are due on a calendar quarterly basis; ~~highway returns are due on a monthly basis. unless - However, authority has been granted the Board to~~ has required or allowed many the taxpayers to file returns on another than the normal reporting basis. A taxpayer cannot retroactively be placed on a reporting basis shorter than its current reporting basis and become subject to a penalty for late payment because the due date for paying tax under the new reporting basis has already passed. Similarly, a taxpayer who has incurred a late payment penalty cannot avoid that penalty by being retroactively placed on a longer reporting basis.

DUE DATES OF RETURNS**0502.15**

Due dates for returns filed on the various reporting basis are as follows:

Quarterly Basis

~~Sales tax, use fuel and vendor use fuel tax r~~ Returns are due on or before the last day of the month following the close of the quarter. Taxpayers who make prepayments must ~~also file returns on or before the 20th day of the month following the month for which the prepayment was made. the prepayment returns in accordance with Section 6472, and must file quarterly returns on or before the last day of the month following the close of the quarter.~~

Odd Quarterly Basis

Where sales tax, ~~use fuel and vendor use fuel~~ accounts are reporting on a special basis which approximates that of the regular quarterly basis, such as a 13-month year, returns are due on or before the last day of the month within one month following the close of the authorized reporting periods.

Monthly Basis

Sales tax, ~~use fuel and vendor use fuel~~ returns for each month are due on or before the last day of the following month following the month to which the returns pertain.

Weekly Basis

~~Returns are due on or before the Wednesday following the close of each weekly period.~~

Yearly Basis

Returns are due on or before the last day of the month following the close of the calendar year ~~(or taxpayer's fiscal year if authority has been granted to file yearly returns on other than a calendar year basis)~~ (reporting basis Y) or fiscal year (reporting basis F), except when the taxpayer. ~~However, where a taxpayer reporting on a yearly basis closes out before the end of the year. (See Section 0502.30.), a closing return is due on or before the last day of the month following the close of the quarterly period in which business was discontinued.~~

When changing an account from a yearly or fiscal year basis to another basis, and the effective date is other than the beginning of the yearly reporting period, the district will furnish the taxpayer with a return to report the expired portion of the year to and including the last day of the quarter which precedes the effective date of the new basis. The tax return for the expired portion of the year is due on or before the last day of the month ~~in which the new reporting basis become effective following~~ the effective date of the new basis.

SALES TAX LIABILITY OF PURCHASERS**0502.20**

A purchaser who becomes liable for payment of sales tax as if he or she were a retailer making a retail sale under Section 6421 of the Sales and Use Tax Law has an obligation to file returns and is subject to the failure to file penalty provisions of Section 6511.

SPECIAL REPORTING BASIS**0502.25**

~~Sales tax returns are due on a quarterly basis unless the taxpayer has been ordered or authorized by the Board to report otherwise before the return on the new basis became due. As a consequence, a taxpayer cannot be placed on a reporting basis shorter than the normal basis retroactively, and thus become subject to a penalty for failure to pay tax when due on such a basis after time for filing a return has passed. Likewise, the taxpayer cannot avoid a penalty by being placed on a longer than normal basis retroactively.~~

CLOSEOUTS**0502.30**

~~Except for taxpayers on an annual reporting basis, if a taxpayer sells a business or stock of goods or quits the business, a final return is not due until the due date of the return for the taxpayer's reporting period during which the closeout occurred. For a taxpayer on an annual reporting basis who closes out the business, a closing return is due on or before the last day of the month following the close of the quarterly period in which business was discontinued. Delinquency penalty applies accordingly. Penalties for negligence and evasion may apply. (See Section 0502.10 for yearly accounts).~~

EFFECT OF LEGAL HOLIDAYS AND WEEKENDS ON DUE DATES**0502.35**

~~The Civil Code provides, in effect, that w~~Whenever the due date of the tax falls on a Saturday, Sunday, or legal holiday, the tax may be paid on the following business day without penalty. The following is a list of legal holidays as set forth in the Government Code:

(Cont.) 0502.35

New Year's Day	January 1
<u>Martin Luther King, Jr. Day</u>	<u>3rd Monday in January</u>
Lincoln's Birthday	February 12
Washington's Birthday President's Day	3rd Monday in February
Memorial Day	Last Monday in May
Independence Day	July 4
Labor Day	1st Monday in September
Admission Day	September 9
Columbus Day	2nd Monday in October
Veterans Day	November 11
Thanksgiving Day <u>and Day After</u>	4th Thursday and Friday in November
Christmas	December 25

Every day appointed by the President of the United States or by the Governor of this State for a public fast, thanksgiving, or holiday.

If one of the foregoing legal holidays falls on a Sunday, the following Monday is a legal holiday.

If Veteran's Day falls on a Saturday, the preceding Friday is a legal holiday.

STATUTORY DATE FALLING ON SATURDAY, SUNDAY OR HOLIDAY 0502.36

Actions other than filing and paying returns, which must be timely, include:

- 1) Waiving the statute of limitations, (Section 6488)
- 2) Filing a petition for redetermination, (Section 6561)
- 3) Filing a claims for refund, (Section 6902)
- 4) Filing a suits for refund, (Sections 6933 & 6934)
- 5) Issuing a determinations, (Section 6487)

The first four of these acts are permitted by taxpayers, and the last is a duty imposed on the Board. All of the acts are required by statute to be performed within a specified period of time.

~~An action is timely if accomplished on the next day following which is not a Saturday, Sunday, or holiday. When the due date of these acts falls on a Saturday, Sunday or holiday, it will nevertheless be timely if filed on the next business day that is not a legal holiday. Taxpayer's actions (1—4, above) are covered by Section 6707 of the Government Code which states:~~

~~"When the last day for filing any instrument or other document with a state agency falls upon a Saturday or holiday, such act may be performed upon the next business day with the same effect as if it had been performed upon the day appointed."~~

~~Actions of the Board are covered by Section 13 of the Code of Civil Procedures which states:~~

~~"Whenever any act of a secular nature, . . . is appointed by law or contract to be performed upon a particular day, which day falls upon a holiday, such act may be performed upon the next business day with the same effect as if it had been performed upon the day appointed."~~

PETITIONS FOR REDETERMINATION

0502.45

~~A penalty attaches to~~ is imposed on the amount of any determination made by the Board ~~and which is not~~ paid on or before the date indicated on the notice, unless a petition is filed on or before that date. The rules for determining when a petition was filed are the same as those for determining when a payment was made.

In preparing a reaudit, the auditor should determine if the petition was timely. The taxpayer should be notified of any penalty to be added by headquarters because of a late protest or payment. Comments on the audit report should also indicate that a penalty will be added by headquarters.

PAYMENTS OR PETITIONS MAILED BUT NOT RECEIVED

0502.50

For purposes of determining whether a late payment or late filing penalty is applicable or a petition is filed timely, Generally a payment or a petition alleged to have been placed in the mail will generally not be treated as received or filed timely unless it is actually received by the Board. Exceptions will be made in those instances where ~~the taxpayer or petitioner~~ furnishes satisfactory proof that the original payment or petition was mailed timely.

JEOPARDY DETERMINATIONS

0502.55

Jeopardy determinations become final within 10 days after service of notice unless a petition is filed within such period and security is deposited in such amount as the Board may deem necessary. The Board will not recognize a petition in connection with a jeopardy determination unless such security is deposited with the Board on or before the date on which penalty attaches, in one or more of the following forms:

- 1) Cash deposits (personal checks not acceptable).
- 2) Certificates of deposit issued by banks.
- 3) Savings and loan certificates.
- ~~4) Bearer bonds issued or guaranteed by the United States Government or by this State.~~

A document ~~that which~~ purports to be a petition filed in connection with a jeopardy determination where security is not deposited is not a valid petition.

EFFECT OF EXTENSIONS FOR FILING RETURNS

0502.60

The various business tax laws provide in part:

"The Board for good cause may extend for not to exceed one month the time for making any return or paying any amount required to be paid under this part. The extension may be granted at any time provided a request therefor is filed with the Board within or prior to the period for which the extension may be granted."

(Cont.) 0502.60

~~Extensions are granted by the appropriate headquarters office unit only and must be requested by the taxpayer. upon Generally, request of a the taxpayer requested the extension from the district office and or on recommendation of the district office will submit thea recommendation the headquarters officeappropriate unit. Extensions are granted for specific periods, and where an extension has been granted, When an extension is granted for a specific period, a delinquency penalty will does not apply if the amount tax is paid on or before the last day of the period for which the extension was granted. However, when an extension is granted, interest at the rate of 1% per month from the date on which tax would have been due must be paid. In cases in which an extension of time has been granted for making a prepayment, interest applies to the unpaid amount of the required prepayment at the same rate.~~

EXTENSION FOR FILING RETURNS**0502.65**

~~These extensions are of two classes, permanent extensions and extensions for particular periods. Both are granted by headquarters office only, upon request of a taxpayer or recommendation of a district office.~~

PENALTY FOR FAILURE TO FILE A RETURN**0503.00****WHEN PENALTY APPLIES****0503.05**

Each taxpayer who has an active account under any of the revenue laws administered by the Board is required to file returns at regular intervals as prescribed by law and required by the Board. The 10% penalty for failure to file a return is imposed on the amount required to be paid to the State for the period or periods for which no return was filed, of taxes due, exclusive of prepayments, with respect to the period for which that return was required. (Also discussed in Section 0501.20.) If the taxpayer is on a monthly reporting basis, for example, and failed to file a return for only one month during a period under audit, a penalty would apply only to tax due for that month. Generally, the appropriate headquarters office unit determines whether a return has been filed for a given period at the time Form BTOE-414 is prepared. Section 6487 provides the statute of limitations on issuing determinations for failure to file a return. Under this section, a determination must be mailed within eight years after the last day of the calendar month following the quarterly period for which the amount is proposed to be determined.

~~However, situations may be encountered where~~ The field auditor should be familiar with the following rules relating to this type of penalty.

DEFINITION OF A RETURN**0503.10**

A return may be defined as a report filed with the Board by the taxpayer, in such form as may be prescribed by the Board, showing the amount of taxes due for the period covered.

WHAT CONSTITUTES FILING A RETURN OR REPORT**0503.15**

~~While the law provides that returns or reports must be filed on forms prescribed by the Board, a return or report will be deemed to have been filed in every case where the taxpayer appears to be acting in good faith and forwards a valid remittance for the amount of the tax declared to be due for a given period. This will include:~~ A return is considered filed when the taxpayer provides in writing:

- ~~(a) Remittance accompanied by correspondence;~~
- ~~(b) Remittance accompanied by a facsimile form;~~
- ~~(c) Remittance accompanied by any statement identifying the remittance;~~
- ~~(d) A check signed by taxpayer or his agent, if payment is identified.~~
- (a) A request that the correspondence be accepted as a return or statement, regardless of how brief, indicating that the taxpayer is attempting to file a return.
- (b) The reporting period for which the correspondence (return) is filed.
- (c) The amount of tax due or that no tax is due.

When the taxpayer has shown due diligence in making every effort to submit what he or she feels is a return, the correspondence submitted should be accepted as a return. Even if the correspondence has no gross sales and or deductions and shows only the net tax figure, it may be accepted as a return if the information listed above is provided. If a taxpayer's check indicates the reporting period and the measure of the tax being paid, it may be processed as a return. As a general rule, if tax due can be calculated from the information provided, the correspondence should be processed as a return. It is important to always consider the taxpayer's intent.

FORM BTOE-401-E NOT A RETURN FOR ALL PURPOSES**0503.20**

The filing of a Form BTOE-401-E, Consumers Use Tax Return, cannot be regarded as the filing of a return with respect to sales tax liability as a seller, or use tax liability as a retailer, but only as the filing of a return with respect to use tax liability as a purchaser.

UNSIGNED NO-REMITTANCE RETURNS**0503.25**

When a document is received purporting to be a tax return, either on one of the forms prescribed by the Board or on some other form, which is not signed by the taxpayer and is not accompanied by a remittance, it will not be regarded as a return.

CLOSEOUTS WITH SECURITIES~~CASH DEPOSITS~~**0503.30**

A cash deposit, certificate of deposit, ~~bearer bond of the U.S. Government or State of California,~~ or an insured deposit in a bank or savings and loan institution is considered to be an advance payment of any tax due on or after the date of closeout. This security ~~will~~may be applied in accordance with the guidelines discussed in the Compliance Policy and Procedures Manual (Section 400.000) to tax due for a period or periods on which the due date is on or after the date of closeout. ~~(Section 0218.06 notes the order of allocation.)~~

A negligence, fraud, or intent to evade penalty does not apply to a deficiency that is paid by the application of a liquid security. When security is available to meet the tax liability (as determined by estimate or otherwise) for periods on which the due date is on or after the closeout, penalty for failure to file a return negligence, fraud or intent to evade does not apply to that part of a deficiency which is paid by application of the security. This is because there was no amount required to be paid to which the penalty can be added. If the taxpayer is on a monthly basis, the quarter or quarters in which the closing month and the preceding month, if involved, occur should be segregated on Form BOE-414-A1 in order to show clearly the application of cash deposit and penalties. In contrast, a penalty for failure to file will apply if a taxpayer submits a late return even though available security exists. Additionally, even if security is available to clear delinquent reporting periods for closed out accounts, the 10% failure to file penalty will apply. A note is added on the billing to inform the taxpayer regarding the penalty.

When the security is not sufficient to meet the liability for the closing period the procedure is as follows:

(a) When a return was filed -

Headquarters will issue a Form BTOE-1210, Demand for Payment, or Form BTOE-1210-1, Statement of Account, for the tax, interest, and penalty. Form BTOE-414-A, Report of Field Audit, will not recommend a penalty because of failure to file but may recommend a penalty for negligence.

(b) When no return was filed -

Form BTOE-414-A will include the penalty for failure to file for the amount of the taxes ~~due only, i.e., the difference between the total tax and the security applied.~~ exclusive of prepayments, with respect to the period for which the return is required. ~~(Further information is contained in Section 0218.00.)~~

When an audit is not to be made, attempts should be made to secure signed returns for periods for which no returns were filed. When the delinquent return or returns cannot be secured, a Form BTOE-414-B, Field Billing Order, or Form BTOE-10, Field Determination, will be prepared to cover the estimated liability.

(Cont.) 0503.30

~~A notation on BOE-414-A under "Special Instructions" should be made when a security is available. See Applying the proceeds of a bearer bond to tax liability requires a memo on the audit report. Further instructions appear in Section 0218.08-0204.12.~~

ERRONEOUS REFUNDS OF CASH DEPOSITS**0503.35**

If a cash deposit available on the close-out date is erroneously refunded instead of being applied to a liability, no penalty or interest will be added to the amount which should have been paid from the cash deposit where these charges would have accrued solely because of the erroneous refund. In cases where nothing is owing at the time a refund is made and a liability is later developed, through an audit for example, a penalty and interest charge will be added.

NO RETURNS FILED FOR PERIOD PRECEDING CLOSING PERIOD**0503.40**

There may be instances where no return was filed for the reporting period immediately preceding the closing period, and where the due date for the preceding period is after the date of closeout; (e.g., the second quarter 19X199, when close-out date was July 13, 19X199). If any part of the ~~liquideash~~ deposit is applied to tax due for such periods, ~~a penalty for failure to file a return or negligence penalty~~ will not attach to the amount of tax so paid. The liquid Cash deposit is considered available on the date of closeout. Therefore, to the extent that it is so applied, there is no amount required to be paid to the State to which penalty can be added. However, if a taxpayer fails to file a timely return for the preceding period, a failure to file penalty will apply to the amount of taxes, exclusive of prepayments, for this period that the return is required.

TAXPAYERS ON A MONTHLY BASIS**0503.45**

In the case of taxpayers reporting on a monthly basis, where no return was filed for the closing month or the preceding month, the quarter or quarters in which such months occur should be broken down on Form BTOE-414-A1, in order to show clearly the application of liquid ~~cash~~ deposit and penalties.

AVAILABILITY OF SECURITY BETWEEN BUSINESS TAXES**0503.55**

All or the remainder of the security of a taxpayer's account may be transferred to another account of the same taxpayer. Information relative to the transfer is contained in the Compliance Policy and Procedures Manual (Section 400.0000)-Section 0218.05.

EIGHT-YEAR LIMITATION PERIOD**0503.60**

~~In the case of failure to file a return, or claim for an additional amount, every determination shall be mailed within eight years after the last day of the calendar month following the quarterly period for which the amount is proposed to be determined. Accordingly, if penalty for failure to file a return applies, the determination must be made within the eight year statutory period.~~

MORE THAN ONE LOCATION**0503.65**

Sellers engaged in business at more than one location must hold a permit for each location, or a subpermit for each location under a consolidated account.

(Cont.) 0503.65

However, taxpayers who hold seller's permits for permanent places of business, and also conduct operations of a temporary nature at places such as fairs or carnivals, are not required to hold separate permits for the temporary operations. They should report their sales made at the temporary location ~~with~~ the returns filed under their regular permit numbers. For multiple location permits, the temporary locations should be listed on BOE-530, "Schedule C- Detailed Allocation by Suboutlet of Uniform Local Sales and Use Tax." For single location permits, the temporary locations should be listed on BOE-530-B, "Local Tax Allocation for Temporary Sales Locations and Certain Auctioneers." The three-year limitation period applies, and the penalty for failure to file returns does not apply, with respect to any unreported sales tax liability incurred at the temporary location during any period for which a person has filed a return for a permanent place of business.

The three-year limitation period applies, and the penalty for failure to file returns does not apply, with respect to any unreported sales or use tax liability incurred in any period for which a person has filed a return for any location. This is true even though the person may operate at one or more other locations for which neither a permit nor a subpermit has been issued.

~~However, w~~Where a taxpayer operating under a consolidated permit fails to include sales in his or her return in his return ~~business-relating to business at a particular location for which he holds a subpermit is held in the taxpayer's return,~~ a penalty for failure to file a return does not apply, but the ten percent penalty for negligence or the 25 percent penalty for fraud may apply if circumstances warrant.

NEGLIGENCE PENALTIES—GENERAL**0504.00****LEGAL BASIS****0504.05**

~~The negligence penalty is imposed at the rate of 10 percent where a deficiency determination is being made by the Board and negligence is present. The Sections relating to the negligence penalty contain the following language read as follows:~~

"If any part of the deficiency for which a deficiency determination is made is due to negligence or intentional disregard of this part or authorized rules and regulations, a penalty of 10 percent of the amount of the determinations shall be added thereto."

NEGLIGENCE DEFINITION**0504.10**

Negligence may be defined in general as a failure to exercise due care. In most cases, the law has ~~fixed no standard of defined the exercise of due care other than the general one that it as such care must be such as that a reasonable~~ reasonable and prudent man-person would exercise under similar circumstances. With respect to business tax matters, ~~it~~ negligence may be further defined as a substantial breach by the taxpayer of some duty imposed by the law or authorized rules and regulations.

NEGLIGENCE VS. INTENTIONAL DISREGARD**0504.15**

~~While technically there may be a legal technical distinction between negligence and intentional disregard of the law or authorized rules and regulations, for all practical purposes, it is impossible to conceive of a situation where intentional disregard would be present without negligence. in that intentional disregard implies something more than negligence. However, intentional disregard is but less than fraud or an intent to evade the tax and is covered by the negligence penalty. Accordingly, the term this penalty will be referred to as the "negligence penalty" will be used to include the penalty for negligence or for intentional disregard, and rules relating to its imposition will be discussed in terms of negligence, with it being understood that in general a penalty will apply wherever negligence is deemed to be present. If, however, a field auditor encounters situation is encountered where he the field auditor believes there is strong evidence of the intentional disregard of the law or authorized rules and regulations, his the audit report should include appropriate comments regarding the evidence of intentional disregard.~~

Field auditors should not assume that a large audit deficiency or overpayment is indicative of either negligence or intentional disregard. As stated in Ssection 0101.20, the auditor is to use his or her highest skill and best judgment to determine whether the amount of tax has been reported correctly. This same judgment and skill should be used to determine whether a penalty should or should not be recommended. As detailed in Ssection 0504.35, a recommendation must be supported by appropriate comments.

ACTS OF AN AGENT, EMPLOYEE OR PARTNER**0504.20**

In general, where an agent, employee, or partner of the taxpayer is guilty of negligence, with a resulting tax deficiency, the 10 percent penalty will apply ~~in the same manner as if the taxpayer himself were guilty.~~ This is true even though the agent, employee, or partner acted without the taxpayer's knowledge or consent, or acted contrary to the express instructions of the taxpayer. Situations may be encountered where the taxpayer has been defrauded by an agent, employee, or partner and as a result did not benefit from the understatement of tax. Whether the negligence penalty is imposed will depend upon whether circumstances made it difficult or impossible for the taxpayer to detect such fraud.

CONDITIONS UNDER WHICH PENALTY APPLIES**0504.25**

~~It will be noted that this~~ The negligence penalty applies only to deficiency determinations ~~made by the Board. Also, and it applies to the total amount of the tax deficiency involved.~~ In the normal field audit, this will mean that, if the penalty applies, it will be for the entire period of the audit regardless of class of transactions involved. Before the penalty is warranted, the following conditions must be present:

- a) A tax deficiency, and
- b) Evidence that any part of the tax deficiency is the result of negligence (or intentional disregard of the law or authorized rules and regulations).

IF APPLICABLE TO ONLY PART OF PERIOD**0504.30**

Situations may be encountered where the condition warranting the imposition of a negligence penalty is not present during the entire period under audit, ~~and where its~~ the imposition of the penalty to the entire amount of the tax deficiency would be inequitable. For example, a complete change of management occurred and conditions under one management were entirely different from those under the other. In these situations, a full statement of the facts involved should be incorporated in the field audit report, and headquarters office will make two determinations, one for the period during which the 10 percent penalty should be included, and another for the period during which it should ~~not be applied~~ be excluded. Two Forms BTOE 414-A will be required in such cases. When considering the recommendation to impose a negligence penalty on a partial audit period, auditors should determine if the taxpayer made any effort during a subsequent period in the audit to correct the situation which led to negligence. If such an effort has been made, a penalty may not be appropriate.

PENALTY COMMENTS REGARDING APPLICATION OF PENALTY ON AUDIT REPORTS OR FBOs**0504.35**

~~If a negligence penalty is being recommended, the reason for the recommendation should be indicated under the "penalty" heading on the back of Form BT 414 A or form BT 414 B. A brief statement of the evidence and facts upon which the auditor relies to support his recommendation for imposition of a penalty should be given.~~

Section 0206.03 states that "a comment should be made on any point which will be of value in connection with making a determination" or in "making a decisions respecting future audits." Penalty recommendations are frequently a source of disagreement between staff and taxpayers. To ensure that both staff and taxpayers understand why a negligence penalty was or was not recommended, Aa penalty comment using the following guidelines must be made on the back of the Form BOE-414-A or BOE-414-B. The sole exception is when the tax liability is less than \$2,500 and no penalty is recommended.

The factors which constitute negligence in keeping records (discussed in section 0505.00), negligence in preparing returns (discussed in section 0506.00), and evasion penalties (discussed in section 0507.00), must be carefully considered before determining whether a negligence or evasion penalty should be imposed. If a negligence penalty is being recommended, the auditor must provide in clear and concise terms the rationale for imposing a penalty. An explanation statement of the evidence and facts upon which the auditor relies to support the recommendation for imposition of a penalty must be given. The explanation must enable supervisors and other reviewers to determine whether the recommendation is consistent with the facts established by the audit. The comments must be factual, not the auditor's opinion, and must not be derogatory to the taxpayer or their taxpayer's employees. All penalty comments must be sufficiently clear to provide continuity for subsequent audits of the taxpayer.

If the auditor believes the imposition of a penalty is inappropriate, he or she must use the same penalty comment guidelines as when recommending a negligence penalty. That is, the comments must be clear and concise, they must enable supervisors and other reviewers to determine whether the recommendation is consistent with the facts established by the audit, and they must be sufficiently clear to provide continuity in the event of a subsequent audit. Canned comments such as "Negligence not noted;" "No negligence noted;" or "No penalty recommended," are **not** acceptable.

If an evasion (fraud) penalty is being recommended, the comment on the audit report must be to the effect that, "Penalty pursuant to Sec. 6485 of the Sales and Use Tax Law is recommended." The details to support the recommendation will be included in the memorandum required by Section 0507.75.

Field auditors are frequently faced with the decision of whether to recommend a penalty on the first audit of a taxpayer. ~~In general,~~ This decision must be based on an objective evaluation of the audit findings and the taxpayer's background and experience. Generally, a penalty should not be recommended. However, there are circumstances where a penalty would be appropriate. Criteria that should be considered, among others, are the taxpayer's prior business experience, the nature and state of the records provided, and whether the taxpayer used an outside accountant or bookkeeper to compile and maintain the records. For example, a penalty may be appropriate in any of the following circumstances: the taxpayer has no records of any kind, the taxpayer has a history of prior permits or business experience, analysis shows that purchases have exceeded reported sales, the taxpayer has two sets of books. The comment "Taxpayer's first audit" should only be used in conjunction with a detailed explanation for the penalty recommendation.

To promote consistency in the application of penalties and the writing of penalty comments, all comments must be reviewed by the auditor's supervisor. In addition, ~~the following~~ special procedures will be used for the following reviews ~~will be made~~:

- Audit tax deficiency over \$25,000 - Reviewed and approved by the auditor's supervisor
- Audit tax deficiency over \$50,000 - Reviewed and approved by the District Principal Auditor in addition to the auditor's supervisor.

This review and approval must be noted by the supervisor (and DPA if applicable) by commenting and signing directly below the auditor's penalty comment on the back of the BOE-414-A or BOE-414-B. This may be a handwritten comment or incorporated as the last line of the penalty comment (e.g., "Reviewed and approved. _____, Supervisor; _____, DPA.")

COMMENTS WHERE NEGLIGENCE PENALTY IS NOT IMPOSED ————— 0504.40

~~Where an audit report indicates that some degree of negligence was present but no penalty is recommended, the auditor should make a brief statement of the facts which he believes justify his "no penalty" recommendation.~~

~~Generally penalty comments are not required when the amount of tax is less than \$2,500. This does not mean that such a penalty should not be recommended when it is warranted.~~

CLASSES OF NEGLIGENCE 0504.45

A taxpayer may be negligent in a number of ways, but there are only two kinds of negligence which will result in a tax deficiency and which may warrant the imposition of the negligence penalty. These are:

- a) Negligence in keeping records, and
- b) Negligence in preparing returns.

NEGLIGENCE IN KEEPING RECORDS**0505.00****GENERAL****0505.05**

Guidelines for the maintenance of records are provided by Regulation 1698, *Records*. In general, this regulation provides that "a taxpayer shall maintain and make available for examination on request by the Board or its authorized representative, all records necessary to determine the correct tax liability under the Sales and Use Tax Law and records necessary for the proper completion of the sales and use tax return."
~~The Board has prescribed by rule that certain records be maintained. Such records include:~~

- Normal books of account ordinarily maintained by the average prudent business person engaged in the activity in questions.
- Bills, receipts, invoices, cash register tapes, or other documents of original entry supporting the entries in the books of account.
- Schedules or working papers used in connection with the preparation of tax returns.

Complete absence of records will constitute ~~prima facie~~ strong evidence of negligence. However, auditors should determine if there are mitigating circumstances for the lack of records (See Section 0505.50). Where records are maintained and a tax deficiency results, various factors must be taken into consideration in determining whether the tax deficiency was due to negligence in keeping records. The term "records" as used herein includes not only those specifically mentioned in Board rulings ~~Regulation 1698~~, but also such supporting data as resale certificates, shipping documents in support of interstate transactions, etc.

TEST FOR NEGLIGENCE IN KEEPING RECORDS**0505.10**

The primary test for negligence is whether a taxpayer keeps the type of records ordinarily maintained by a reasonable and prudent businessperson with a business of similar kind and size. If the evidence indicates that a taxpayer failed to keep those such records which a reasonable and prudent businessman, engaged in a business of similar kind and size, would keep in order to compile his and, as a result, failed to compile his or her tax returns with a reasonable degree of accuracy, and in order cannot to substantiate the reported amounts in the event of an audit by our staff when audited, negligence will be deemed to be present is indicated and the 10 percent penalty should may be recommended appropriate.

RECORDS NEED ONLY BE ADEQUATE FOR TAX PURPOSES**0505.15**

Records need only be adequate for tax purposes. The fact that the records may not be adequate for the purpose of preparing balance sheets or profit and loss statements, or for furnishing accurate cost data, information to stockholders, creditors, or others interested in the business does not constitute negligence for tax purposes.

RECORDS NEED ONLY BE ADEQUATE FOR TYPE OF BUSINESS**0505.20**

Records need only be adequate to meet the tax requirements of the type of business involved. For example, a small restaurant may require a very simple set of records for sales tax purposes, whereas, a large department store, oil company, automobile dealer, or contractor will require a much more complex accounting system.

NEGLIGENCE OF OTHER TAXPAYERS-NO EXCUSE**0505.25**

~~If taxpayer appears guilty of negligence in keeping records, he~~ A taxpayer should not be relieved of penalty for negligence in keeping records merely because there are many other taxpayers engaged in the same kind of business who also are negligent in keeping records. Each individual case should be decided on its own merits.

EFFECT OF LACK OF KNOWLEDGE ON PART OF TAXPAYER**0505.30**

~~If taxpayer appears to have been negligent in keeping records, he~~ A taxpayer should not be relieved of a penalty for negligence in keeping records merely because he or she is unaware of the requirements of the law. However, while lack of knowledge is no defense to the negligence penalty, a taxpayer of little education should not be expected to keep records in as good a form as a taxpayer who has wide knowledge of correct accounting principles. The taxpayer, moreover, cannot be regarded as negligent merely because his or her records may be kept in a foreign language.

ERRORS IN KEEPING RECORDS**0505.35**

Where records are adequate for tax purposes but numerous errors have been made which result in understatements of tax, the test for negligence is whether or not the taxpayer exercised due care in keeping the records.

ERRORS DO NOT NECESSARILY CONSTITUTE NEGLIGENCE**0505.40**

No matter how carefully records are prepared and checked, some errors may occur. Accordingly, where errors are made in keeping records, the relative frequency and importance thereof must be considered before a taxpayer may properly be regarded as negligent. Due consideration should be given to any particular accounting difficulties which may be inherent in the taxpayer's business.

CONSIDERATIONS IN CLASSIFYING ERRORS**0505.45**

To determine whether errors constitute negligence, the following should be considered:

- a) The frequency of the errors, relative to the volume of transactions. The number of errors found must be considered in relation to the total number and dollar amount of the same type of transaction in the audit period.
- b) ~~The size of the ratio of understatement resulting therefrom, and to reported amounts.~~ This ratio may be used in a variety of ways. For markup audits, the most appropriate evaluation is the ratio of understatement to reported taxable measure, particularly when reported taxable sales have been impeached. For audits where taxable measure is based on a percentage of total sales or claimed deductions, the most appropriate evaluation is the measure of understatement to total reported sales or claimed deductions. For both of these methods, a large ratio of understatement may be indicative of negligence. If the audit measure is derived from a statistical sample, comparison of the error percentage in the prior audit may be appropriate if the same items are being sampled. A substantive increase or comparable error percentage may be indicative of negligence. However, it must be noted that a ratio of understatement is not, in and of itself, proof of negligence. A ratio should be considered in conjunction with other factors to determine whether negligence has occurred.

- c) The probable cause. Auditors should consider the probable cause of errors found by audit. The cause of errors may result from procedural or operational problems unrelated to negligence. For example, significant changes in sales volume from a prior audit may cause errors that result from staffing problems rather than negligence. Similarly, a business with a large volume of small dollar transactions may find it infeasible to hire the level of staff that would result in the total elimination of errors.

If ~~they~~ the errors are ~~more too~~ frequent in relation to the volume of transactions, or if they result in a higher ratio of understatement than would be expected of a reasonable and prudent business ~~man~~ person engaged in a business of similar kind and size, or if there appears to have been an absence of due care, the 10 percent penalty should apply.

DESTRUCTION OF RECORDS

0505.50

All records pertaining to transactions involving sales or use tax liability must be preserved for a period of not less than four years unless the Board authorizes in writing their destruction within a lesser period.

Whether unauthorized destruction of records constitutes negligence depends on the circumstances in each case.

Where Records Accidentally Destroyed

When the taxpayer has exercised due care in preserving the records, but they have been accidentally destroyed in spite of such care, the taxpayer cannot be said to have been negligent in failing to retain records. In reaching such a conclusion ~~cases~~, the auditor should be satisfied ~~himself~~ that there was an actual accidental destruction ~~the records were actually destroyed, and that the destruction was accidental.~~

Where Records Intentionally Destroyed

Where records have been intentionally destroyed or destroyed as a result of negligence or lack of due care on the part of the taxpayer, ~~and a~~ any tax deficiency that is established, ~~it will be presumed that the deficiency is due to~~ to have been the result of the taxpayer's negligence in destroying the records, ~~and t~~ The 10 percent penalty will apply unless there is evidence that the deficiency is not the result of the destruction of the records.

WHERE RECORDS ARE INADEQUATE

0505.55

~~Where records are inadequate for tax purposes because they fail to meet the tests in Section 0505.10 and a tax deficiency results, the 10 percent penalty will apply unless there is evidence that the deficiency is not due to the inadequacy of the records.~~

NEGLIGENCE IN PREPARING RETURNS**DEFICIENCY DUE TO MISUNDERSTANDING****0506.05**

Where there is evidence that the tax deficiency resulted from a reasonable misunderstanding by the taxpayer concerning the application of the tax, no penalty will apply. However, where the taxpayer has been advised, as a result of a prior audit or by other means such as a specific letter, documented telephone call, or special industry notice, that the unreported items were subject to the tax, it is indicative of intentional disregard and a penalty may apply. ~~¶The 10 percent penalty normally shall~~ should not apply unless when there are mitigating circumstances such as efforts an attempt on the part of the taxpayer to report the items, or changes in the taxpayer's type of business or business operations that affected reporting of the transactions in question.

TEST FOR NEGLIGENCE IN PREPARING RETURNS**0506.10**

As in the case of negligence in keeping records, the test for negligence in preparing returns is whether the taxpayer failed to exercise that degree of care which would be exercised by the ordinary prudent business ~~man~~ person who is engaged in a business of a similar kind and size, and who in good faith has attempted to prepare returns with a reasonable degree of accuracy.

MECHANICAL ERRORS**0506.15**

Mechanical errors in compiling returns do not constitute negligence unless they are sufficiently frequent or sufficiently large in amount to meet the test for negligence.

ERRORS IN PRINCIPLE ~~APPLICATION~~ OF LAW**0506.20**

Errors in ~~principle in compiling~~ application of law when completing returns do not constitute negligence unless there is evidence that the taxpayer failed to exercise due care in determining whether the transactions in question were subject to tax; ~~that is,~~ This can be determined by ascertaining whether he the taxpayer has acted in good faith and has been made a reasonably diligent in ascertaining through inquiry or otherwise, effort to learn how the tax applies to his or her business. The average taxpayer is neither a lawyer nor an accountant and can only be expected to exercise the amount of diligence due from a business ~~man~~ person in his or her circumstances.

DUTY TO ~~AND~~ EFFECT OF FAILURE TO MAKE INQUIRY**0506.25**

Where ~~the taxpayer there is in~~ there is in doubt concerning the correct application of the tax, ~~he is under the tax~~ the taxpayer has a duty to make an inquiry. ~~If he the taxpayer fails to make an inquiry, the 10 percent penalty may apply.~~ or if he If the taxpayer does make an inquiry and fails to act upon the results of the inquiry, the 10 percent penalty generally should apply.

EFFECT OF ERRONEOUS INFORMATION**0506.30**

If a taxpayer was in doubt as to the application of the tax, ~~and made an inquiry, and was misinformed, with the result that he and underreported his tax based on that misinformation,~~ the negligence penalty should not be imposed if the inquiry was made in good faith to any of the following:

- a) The headquarters office,
- b) The district office,
- c) Any representative of the Board who is held out to the taxpayer as qualified and was authorized to give an opinion.

The taxpayer ~~is~~ should be required to furnish reasonable proof that ~~he had been erroneously informed the~~ underreported tax was the result of erroneous information from the Board. In addition, the taxpayer should furnish a written statement of his or her interpretation of the information secured from the above sources.

Relief from application of a negligence penalty is based on a finding that there was actually no negligence and it should not be confused with relief under Section 6596. Relief under Section 6596 includes relief from tax, interest, and penalty where there has been written advice by the Board in response to a request in writing from a specifically identified taxpayer who, in turn, described fully the specific facts and circumstances of the activity or transaction for which advice was requested. No Approval of a Section 6596 credit or adjustment will be made without has been delegated by the elected Board approval to the Deputy Director, Sales and Use Tax Department, or his or her designee.

FAILURE TO REPORT PURCHASES SUBJECT TO USE TAX

0506.35

The same standards which determine the application of the negligence penalty to tax deficiencies arising from an understatement of gross receipts or an overstatement of deductions are ~~to be taken into consideration when determining~~ used to determine the application of the negligence penalty to a tax deficiency arising from failure to report purchases subject to use tax.

MORE THAN ONE LOCATION

0506.40

~~Failure on the part of a~~ A taxpayer operating under a consolidated permit ~~to include in his returns business who fails to include on returns sales relating to a location of for which a subpermit is held may be presumed to be negligent for all tax due for such business that sublocation unless such omissions are infrequent and do not constitute a substantial part of the total deficiency.~~

OTHER TYPES

0506.45

While the two foregoing are rather obvious classes of negligence in preparing returns, it is not intended that the imposition of the penalty for this reason be so limited, since many other types of situations will be encountered where items have been omitted from returns for no apparent reason except that taxpayer was negligent.

WHERE WORKING PAPERS ARE DESTROYED

0506.50

Where the auditor finds that working papers used by the taxpayer in preparation of the tax returns have been destroyed and the taxpayer is unable to explain substantial deficiencies in reporting, taxpayer should be given a reasonable opportunity to prepare new working papers or to explain how amounts reported on returns were computed. Failure or inability on the part of the taxpayer to do so will ordinarily constitute evidence of negligence and warrant the imposition of the 10 percent penalty.

EVASION PENALTIES**0507.00****GENERAL****0507.05**

Penalties for fraud or intent to evade are imposed only in connection with deficiency determinations ~~or determinations made by the Board if no return is made.~~ *It is important to remember that the Board has the burden of supporting the imposition of an evasion penalty.*

Sections of the ~~business tax laws~~ Sales and Use Tax Law dealing with such penalties are:

- a) ~~Deficiency Determinations (6485). "If any part of the deficiency for which a deficiency determination is made is due to fraud or to an intent to evade this part or authorized rules and regulations, a penalty of 25 percent of the amount of the determination shall be added thereto."~~
- b) ~~Determination If No Return Made (6514). "If the failure of any person to file a return is due to fraud or an intent to evade this part or rules and regulations, a penalty of 25 percent of the amount required to be paid by the person, exclusive of penalties, shall be added thereto in addition to the 10 percent penalty for failure to file."~~
- a) Sections 6072 and 6094.5 - misuse of resale certificate to evade tax, 10% or \$500 whichever is greater.
- b) Section 6485 - fraud or intent to evade deficiency determination, 25% of determination.
- c) Sections 6485.1 and 6514.1 - registration of a vehicle, vessel, or aircraft outside of this state for the purpose of evading tax, 50% of tax due.
- d) Section 6514 - fraud or intent to evade tax by failure to file return, 25% of tax, in addition to the mandatory Section 6511 failure to file penalty of 10%.
- e) Section 7155 - failures to obtain valid permit by due date of first return for the purpose of evading tax, 50% of tax due before permit obtained.

DEFINITION OF EVASION PENALTIES**0507.10**

Fraud may be defined as conduct intended to deprive the State of tax legally due. An intent to evade may be defined as an intent to escape the tax through deception or misrepresentation. Although there may be a ~~technical-legal~~ distinction between fraud and an intent to evade, the terms will be considered synonymous in this manual, and penalties imposed as a result of such act will be referred to as evasion penalties.

EVASION VS. NEGLIGENCE PENALTIES**0507.15**

Evasion ~~penalties go~~ is a step beyond negligence ~~penalties~~. When negligence penalties are recommended, the facts should indicate that the taxpayer failed to exercise due care in keeping records or preparing returns or intentionally ignored certain duties or requirements.

The evasion penalties are to be applied if it can be shown that the taxpayer not only failed to fulfill certain duties, but such failure was intentional and for the purpose of evading part or all of ~~this the~~ true tax liability.

~~There must be adequate and factual evidence that failure to comply with requirements of the law resulted from intentional and deliberate acts on the part of the taxpayer.~~

CONDITIONS WARRANTING AN EVASION PENALTY**0507.20**

Before an evasion penalty is warranted can be imposed, there must be evidence that an existing tax deficiency is the result of a deliberate intent to evade payment. Where there is a substantial deficiency which cannot be explained satisfactorily as being due to an honest mistake or to negligence and where the only reasonable explanation is a willful attempt to evade payment, the 25% evasion penalty should apply. The size of the deficiency in relation to the tax reported should be taken into account. The indication that a deficiency is due to intent to evade increases in direct proportion to the ratio of understatement when it cannot otherwise be satisfactorily explained.

EVIDENCE OF EVASION**0507.25**

It is very difficult to secure direct evidence that a taxpayer intended to evade ~~his~~ a tax liability. In most cases, it is necessary to rely on circumstantial evidence. Certain acts are of such nature that they are evidence that a deliberate attempt has been made to evade payment of tax, and that an evasion penalty is warranted. Those commonly encountered include ~~are~~:

- a) Falsified records, especially when more than one set is kept;
- b) Substantial discrepancies between recorded amounts and reported amounts which cannot be explained;
- c) Willful disregard of specific advice as to applicability of tax to certain transactions;
- d) Failure to follow the requirements of the law, Knowledge of which requirements of the law as is evidenced by permits or licenses held by taxpayer in prior periods ;
- e) Tax properly charged, evidencing a knowledge of the requirements of the law, but not reported;
- f) Transferring accumulated unreported tax from a tax accrual account to another income account.

Evidence of evasion must be documented. In addition to the findings of substantial discrepancies and proper charging of tax or tax reimbursement, other evidence of evasion must be included in the audit working papers. Such evidence can include copies of falsified records, Board letters providing specific advice, copies of previous permits and applications, and evidence of improper transfers of unreported tax. A summary of the evidence must be provided in the audit working papers. The summary must reference the schedules providing the evidence of evasion and must provide an explanation of how the evidence supports the recommendation for an evasion penalty.

BURDEN OF PROOF**0507.30**

As a matter of law, fraud is never presumed but must be proven and the burden of proof is on the Board. However, the burden of proof is not beyond a reasonable doubt as in a criminal prosecution. (See Helvering v. Mitchell (303 U.S. 391 406)). As noted in Sections 0507.20 and 0507.25, a taxpayer's intent to evade the tax is the key element to proving fraud. The mere fact that a taxpayer has a substantial tax liability does not in and of itself prove intent. Rather the evidence must support intent. For example, a consistent pattern of underreporting may indicate evasion, particularly if there is no other explanation for the understatement. However, additional evidence such as falsified records must be provided to support fraud when the underreporting is random. In all cases where a fraud penalty is recommended, the district administrator must ~~be prepared to~~ submit evidence of a substantial nature that the taxpayer knowingly committed specific acts with the intention of defrauding the State of tax, which was legally due. (See Section 0507.75 ~~0508.20~~.)

COURT DECISIONS

The United States Supreme Court in *Helvering v. Mitchell* (303 U. S. 391-406) and the U. S. District Court, W. D. Kentucky, in *White v. United States* (20 F. Supp. 632) have held in effect that to justify a fraud penalty in a tax case, it is unnecessary that the facts also support a criminal prosecution. Both cases involved the 50 percent penalty under the Federal Income Tax Act which is imposed, "if any part of any deficiency is due to fraud with intent to evade tax". In the first mentioned case, the court held that the imposition of the penalty was proper notwithstanding a previous acquittal on a criminal charge involving the same facts, and also pointed out that "they (penalties) are provided primarily as a safeguard for the protection of the revenue and to reimburse the Government for the heavy expense of investigation and the loss resulting from the taxpayer's fraud." In the second case, the court said, in part, "some courts hold the rule that a fraud penalty cannot be imposed on the taxpayer unless the facts would also support a criminal prosecution. I do not so view the act here in question."

EVASION BY AGENT, PARTNER OR EMPLOYEE

0507.40

Auditors should recommend the 25 percent penalty when a taxpayer's agent, partner, or employee has acted with intent to evade tax payment, even though such attempted evasion occurred without taxpayer's knowledge or consent. This is because the fraud of the agent is imputed to the principal except. ~~There is an exception~~ when the principal taxpayer is defrauded by ~~an~~ the agent or employee. For example, when tax has been understated to cover up money or property stolen from the taxpayer, such an evasion will not be imputed to the taxpayer and the penalty should not apply. Generally, if a taxpayer has not benefited from the intent to evade, the evasion penalty should not apply.

AMOUNT TO WHICH PENALTY APPLIES

0507.45

The evasion penalties under sections 6485 and 6514 are imposed if any part of the deficiency is due to fraud or an intent to evade. Therefore the penalty will apply to the entire amount of the deficiency. In unusual cases where it appears inequitable to apply the penalty to an entire deficiency because, for example, a change in management during an audit period resulted in the discontinuance of fraudulent practices, or the reverse, field audit reports should be accompanied by *a full statement of the circumstances involved*, and separate ~~Forms BOE-414-A should be submitted (although one Schedule 414-A2 will suffice).~~ Headquarters will Forms BOE-414-A should be submitted (although one Schedule 414-A2 will suffice). Headquarters will make two determinations, one with the penalty and one without.

Except for the penalties imposed under sections 6485 and 6514, evasion penalties should be applied only to the portion of the deficiency which was ~~at~~ the result of the act or acts that constituted evasion.

KNOWINGLY OPERATING WITHOUT A PERMIT

0507.50

Section 7155 of the Sales and Use Tax Law imposes a 50% penalty of the tax due when a person knowingly fails to obtain a seller's permit. This penalty may be assessed when all of the following factors are present:

1. The taxpayer did not obtain a permit prior to the date the first tax return was due.
2. The taxpayer, while operating without a permit, knew a permit was required.
3. The average measure of tax liability during the period which the taxpayer operated without a permit was more than \$1,000 per month.

In addition, the Section 7155 penalty may apply when a person is engaged in business at more than one location but knowingly fails to obtain a permit or subpermit for each location.

MISUSE OF A RESALE CERTIFICATE**0507.55**

Sections 6072 of the Sales and Use Tax Law imposes a penalty of 10% or \$500, whichever is greater, for each transaction where a purchaser knowingly issues a resale certificate while the person is not actively engaged in business as a seller, for personal gain or to evade the payment of the tax. Section 6094.5 of the Sales and Use Tax Law imposes the same penalty, 10% or \$500, whichever is greater, for each transaction where a purchaser knowingly gives a resale certificate for personal gain or to evade the payment of the tax, for property which he or she knows at the time of purchase will not be resold in the regular course of business.

When a resale certificate is accepted by a seller and it appears to meet all of the requirements of a valid resale certificate, it should be assumed the certificate was accepted in good faith. Unless there is other information that controverts this assumption, the seller should not be held liable for the tax. Instead, the purchaser who knowingly issued an improper certificate will be pursued for the tax and penalty. If, however, it is disclosed that the seller makes a practice of accepting defective resale certificates, the seller's good faith is in doubt. In this case, tax should be asserted against the seller and a dual determination issued against the purchaser for the tax and penalty.

OUT OF STATE REGISTRATION OF VEHICLE, VESSEL OR AIRCRAFT**0507.60**

Sections 6485.1 and 6514.1 provide a 50% penalty on a purchaser who registers a vehicle, vessel, or aircraft outside of California (i.e., in another state or foreign country) for the purpose of evading the tax. The standards of proof for this penalty are similar to those for fraud in general.

The penalty under sections 6485.1 and 6514.1 may not be asserted in conjunction with a penalty under section 7155 (failure to obtain a permit) or sections 6485 or 6514 (fraud or intent to evade). However, this penalty may be asserted in conjunction with penalties under section 6511 (failure to file) or sections 6072 or 6094.5 (misuse of resale certificate).

The penalty will generally be applicable when the purchaser is a California resident who purchased a vehicle, vessel, or aircraft for use in California and can provide no convincing evidence for registration out of state other than avoidance of the tax.

MULTIPLE PENALTIES**0507.65**

Under certain circumstances, more than one penalty may apply to the same determination:

- The Section 6511 penalty (10% for failure to file return) should be applied along with a Section 6514 penalty (25% for fraud or intent to evade tax by failure to file return). A Section 6511 penalty may be applied with a Section 7155 penalty (50% for failure to obtain a permit) if appropriate.

However, an auditor should not impose two or more fraud or evasion penalties against the same determination when the penalties apply to the same series of acts or course of action:

- If a person with intent to evade tax fails to obtain a permit and fails to file a return, either the Section 7155 penalty (50% for failure to obtain a permit) or the Section 6514 penalty (25% for fraud or intent to evade tax by failure to file return) may be imposed, but not both.
- The Section 7155 penalty should not be applied in conjunction with a section 6485 penalty (25% for intent to evade).

The series of acts or course of action involved in the misuse of a resale certificate for purpose of evading payment of tax on **purchases** are different from those involved in failing to obtain a permit for the purpose of evading the tax on **sales**. Therefore the following penalties may apply to the same determination:

- A Section 6511 penalty (10% for failure to file a return) may be applied with a Section 6072 or 6094.5 penalty (improper use of resale certificate) since the 6511 penalty is not for fraud or intent to evade the tax. Similarly, the Section 7155 penalty (50% for failure to obtain a permit) may be added to the same determination if appropriate.

STATUTE OF LIMITATIONS FOR EVASION PENALTIES**0507.70**

The application of evasion penalties can extend determinations beyond the otherwise applicable statute of limitations set forth in Section 6487 (i.e., three or eight years). Therefore, tax can be assessed and penalties imposed for prior periods in which the taxpayer intentionally understated his or her tax liability. However, proof that the taxpayer intentionally understated his or her tax liability **within** the otherwise applicable statute of limitations (three or eight-years) is not by itself sufficient to support an evasion penalty for periods **outside** the statutory period. Ideally, evasion should not be asserted for periods outside the applicable statutory period (three or eight years), unless records for the outlawed periods are available, they establish an actual tax liability, and support the assertion of fraud.

Where audits have previously been made of prior periods and no evasion disclosed, such periods will not be included in subsequent audits even though evasion is discovered in periods covered by such subsequent audits unless there is a definite showing:

1. that evasion was present during the periods previously audited, and
2. that such evasion was not discovered at the time because information necessary to its detection was concealed from the auditors who made the previous audit, or because of some other act or fraud by the taxpayer.

APPROVAL OF EVASION PENALTIES**0507.75**

In every instance where an evasion penalty is recommended, the audit report must be accompanied by a memorandum to the Program Planning Manager with an approval signed by the District Administrator. If the District Administrator is absent for an extended period the memorandum may be signed by the acting administrator. The memorandum must stand on its own and include in detail all of the facts and circumstances which are the basis for the evasion penalty recommendation. The facts and circumstances should be the same as those provided in the audit working papers and must cover any periods outside the statute of limitations. Any evidence that is not included in the audit working papers must be attached to the memorandum. If an audit includes related taxpayers, a separate memorandum must be prepared for each taxpayer on which the auditor recommends an evasion penalty. Approval to impose the evasion penalty will be obtained from the Program Planning Manager concurrently with the review process by the Centralized Review Section. *A copy of the memorandum may not be provided to the taxpayer or a representative until it is approved by the Program Planning Manager.*

MISCELLANEOUS**0508.00****CLOSEOUTS WITH CASH DEPOSITS** **0508.05**

~~Penalties will not apply to any part of a deficiency which is paid by application of a cash deposit to the closing reporting period (month, quarter, etc.) or for the preceding period, if the due date for such period is after the date of closeout. To the extent of the cash deposit, there is no amount required to be paid to the State for such periods to which penalty can be added. If the taxpayer is on a monthly basis, the quarter or quarters in which the closing month and the preceding month, if involved, occur should be segregated on Form BT 414 A1 in order to show clearly the application of cash deposit and penalties.~~

THREE-YEAR LIMITATION PERIOD **0508.10**

~~Sections of the business tax laws provide that the three year period within which a deficiency determination may be made against a given person does not apply where there has been fraud or intent to evade the law or authorized rules and regulations on the part of such person. Accordingly, where the 25 percent penalty applies, the entire period of operations will be included in the audit, except as indicated in the following section.~~

PERIODS PREVIOUSLY AUDITED **0508.15**

~~Where audits have previously been made of prior periods and no evasion disclosed, such periods will not be included in subsequent audits even though evasion is discovered in periods covered by such subsequent audits unless there is a definite showing:~~

- ~~a) That evasion was present during the periods previously audited, and~~
- ~~b) That such evasion was not discovered at the time because information necessary to its detection was concealed from the auditors who made the previous audit, or because of some other act or fraud by the taxpayer.~~

LETTER OF ADMINISTRATOR'S APPROVAL **0508.20**

~~In every instance where an evasion penalty is recommended, the audit report must be accompanied by a letter addressed to the Principal Tax Auditor — Headquarters and signed by the District Administrator. In the absence of the administrator, the letter is to be signed by an assistant designated by him. This letter is to include in detail all of the facts and circumstances which are the basis for the evasion penalty recommendation.~~

FAILURE TO OBTAIN EVIDENCE THAT OPERATOR OF CATERING TRUCK HOLDS VALID SELLER'S PERMIT **0508.05**

Any person making sales to an operator of a catering truck who has been required by the Board pursuant to Section 6074 of the Sales and Use Tax Law to obtain evidence that the operator is the holder of a valid seller's permit issued pursuant to Section 6067 of the Sales and Use Tax Law and who fails to comply with that requirement shall be liable for a penalty of five hundred dollars (\$500) for each such failure to comply.

FAILURE OF RETAIL FLORIST TO OBTAIN PERMIT**0508.10**

Any retail florist (including a mobile retail florist) who fails to obtain a seller's permit before engaging in or conducting business as a seller shall, in addition to any other applicable penalty, pay a penalty of five hundred dollars (\$500). For purposes of this regulation, "mobile retail florist" means any retail florist who does not sell from a structure or retail shop, including, but not limited to, a florist who sells from a vehicle, pushcart, wagon, or other portable method, or who sells at a swap meet, flea market, or similar transient location. The term "retail florist" does not include any flower or ornamental plant grower who sells his or her own products.